Oil & Money Market Report

March-2012 Issue

In this Report

Credit Facilities grew by 0.9% in February to reach KWD 25.84 bn, a signal that the credit market may remain tight on the back of low demand for credit amid challenging business environment along with conservative lending policies followed by local lenders.

Personal facilities continued its upward trend during February to increase by 1.5% fuelled by high consumption As of February 2012, personal facilities recorded KWD 9.14 bn, accounting for 35% of total credit.

Residents' Deposits with local banks grew at 0.9% during February, driven by growth in private sector deposits which grew at 1.1% to KWD 27.1 bn.

M2 continued the last six month's upward trend, to rise by KWD 285.6 mn or 1% during February-12 and stand at KWD 28.2 bn.

Oil Market: Oil prices rose in March supported by bullish better than expected US economic data and revived political tensions in the Middle East which helped boost the risk premium in crude oil prices.

OPEC Reference Basket, Kuwait Blend Spot Price and European Brent closed the month at USD 121.6/b, USD 120.3/b, and USD 124.9/b, respectively.

World oil demand for 2012 is forecast to grow by 0.95 mb/d to average 88.63 mb/d.

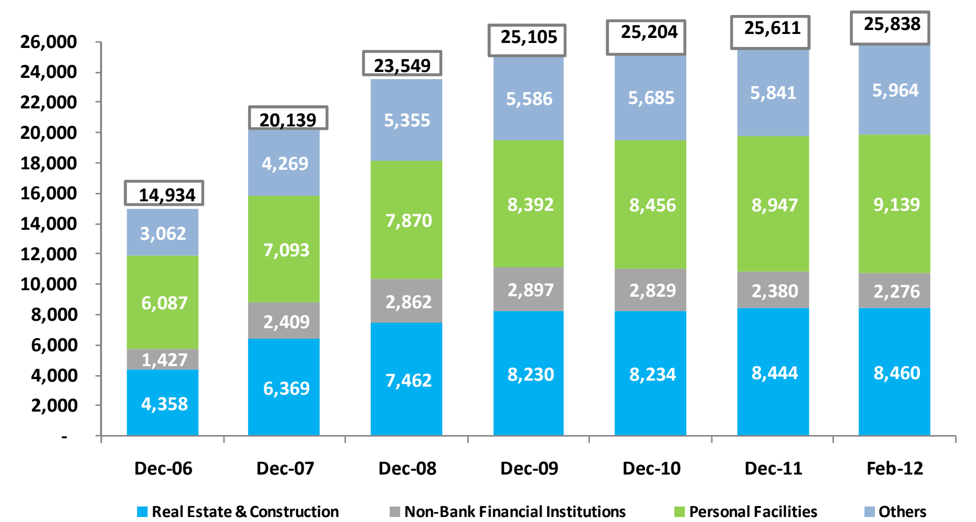
Credit Facilities by Kuwaiti Banks

During February-12, credit facilities extended by local banks reversed last month's marginal drop to add around KWD 242 mn and stand at KWD 25.84 bn. During 2011, credit facilities saw a marginal increase of 1.6% of around KWD 407 mn, indicating the challenging business environment for enterprises along with banks' conservative lending policies and the low appetite for credit. Currently, there is no clear sign of potential revival in credit in the short-term as demand for credit by the private sector is not picking up and the continuous delay in implementing the development plan is having an adverse impact on the credit market. The slowdown in credit growth is expected to continue through Q1-12 and Q2-12 on the back of tight credit conditions, insolvency problems suffered by local firms, scarce investment opportunities in the local market along with a rise in default risk by distressed and highly indebted firms.

Personal facilities, the key growth driver of credit and its major component, continued the upward trend for the tenth consecutive month growing at 1.5% in February to reach KWD 9.14 bn, hence comprising around 35% of banks' loan portfolios. During 2011, personal facilities grew at 5.8% fuelled by high consumption and robust growth in the retail sector accompanied with the significant increase in public sector salaries.

Credit facilities for the purchase of securities, which account for 30% of personal facilities, unexpectedly grew in Feb-12 by 3.5% to stand at KWD 2.7 bn after witnessing stagnant growth since January-10. Given, the deterioration in the local and international equity markets due to the financial crisis, the structure of credit facilities, with the highest percentage of funds channelled into the equity market, has exposed banks to a high default risk by individual investors who are heavily invested in the local and regional bourses. However, as the local bourse witnessed a rebound in 2012, liquidity slightly flowed back into the markets, pushing credit facilities for the purchase of securities higher.

Chart 1. Development in Credit Facilities since December 2006

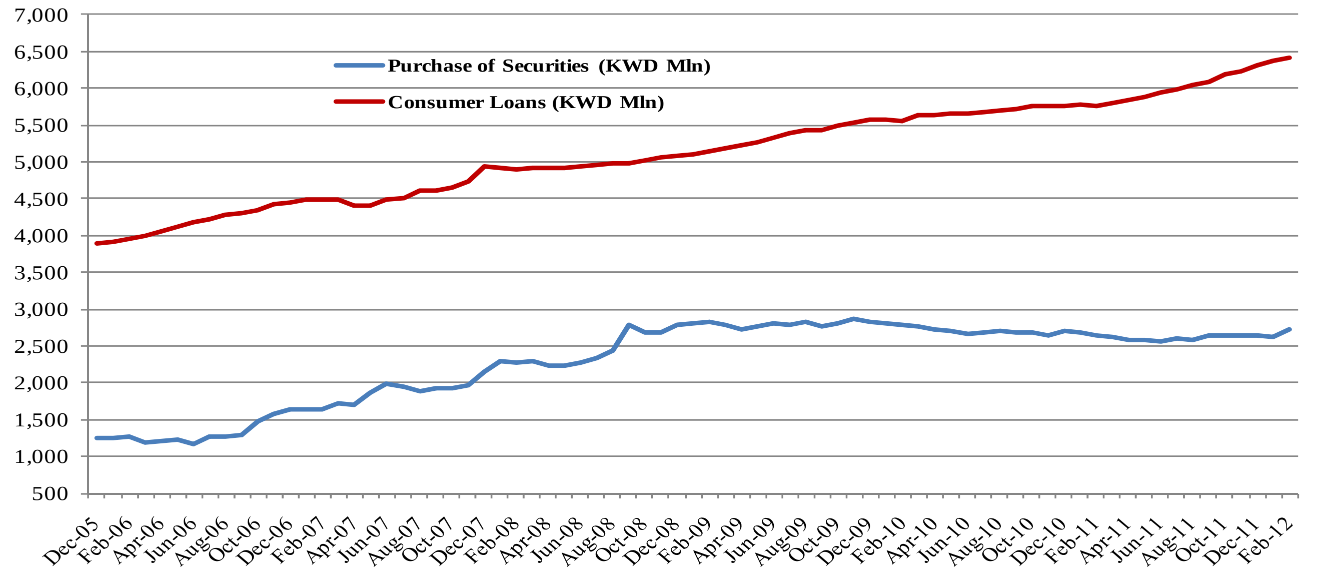


Source: KAMCO Research & Central Bank of Kuwait

KAMCO Investment Research Department
M2, Al-Shaheed Tower, Khalid Bin Al-Waleed Street- Sharq, P.O. BOX : 28873, Safat 13149, Kuwait
Tel : +(965) 1 852 626 , Fax : +(965) 2249 2395
Email: Kamcoird@kamconline.com Website: http://www.kamconline.com

During 2011, credit to purchase securities fell by 2% or KWD 56 mn in large part due to the deleveraging amid high market risk and volatility in local and international markets. This made banks shift their lending policy by extending credit to households and the productive economic sectors guaranteed by sustainable cash flows. Chart 2 shows the sustainable growth in consumer loans (excluding purchases of securities) since December 2005 indicating a robust growth amid increase in consumption and purchasing power fuelled by salary increase and economic prosperity. Consumer loans grew at a 6-year CAGR of 8.4% since 2005 up from KWD 3.9 bn to KWD 6.3 bn in Dec-11. On the other hand, following 5 consecutive years of strong growth rates over the period 2004-2008 with a CAGR of 34.5% fuelled by buoyant market and ample liquidity, growth in credit to the purchase of securities slowed down significantly during 2009 to 1% and then followed a downtrend in 2010 and 2011 with a yearly contraction of 5% and 2% respectively.

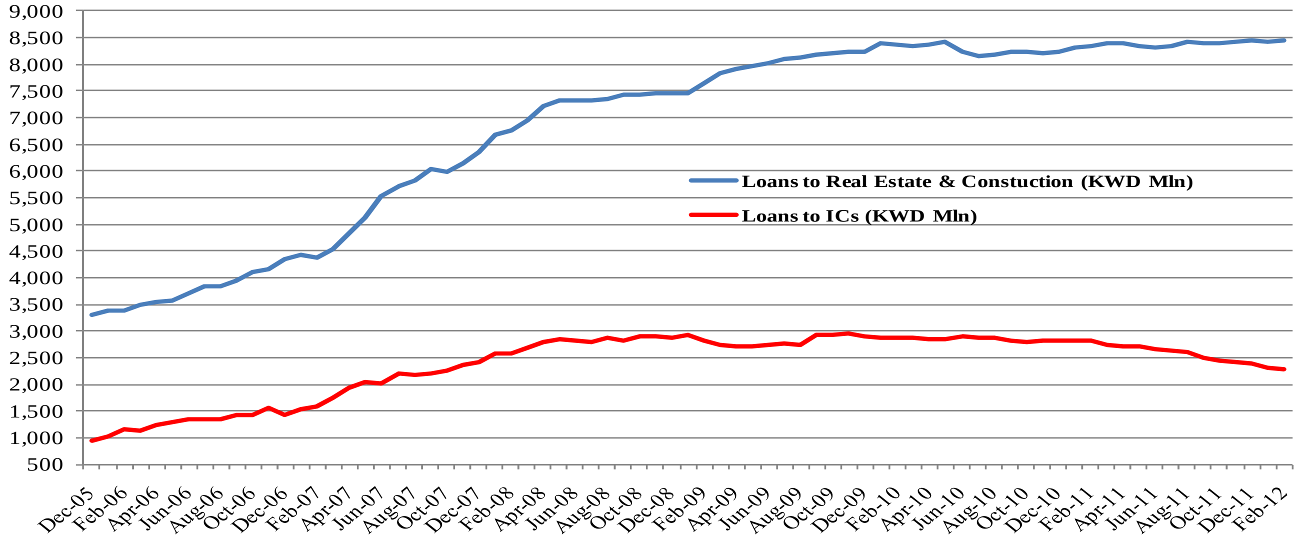
Chart 2. Evolution of Credit Facilities for Purchase of Securities versus Consumer Loans since Dec-05



Source: KAMCO Research & Central Bank of Kuwait

Loans to the real estate and construction sectors, which have together comprised an average of 32% of banks' loan portfolios since Dec-2004, increased by KWD 25.3 mn during February-12 to reach KWD 8.46 bn. During 2011, real estate loans grew 2.5% following stagnant growth in 2010. Chart 3 shows that since 2008, real estate loans have started to lose momentum driven by the slowdown in property market and the depreciation in asset prices. Following a 3-year CAGR of 40% over the period 2004-2007, growth in loans to the real estate & construction sectors dropped sharply to 17% in 2008 then to 10% in 2009 and remained flat in 2010. Given the slowdown in the real estate market and the challenging business environment faced by real estate companies and contractors in Kuwait, high exposure to this sector by banks indicates that further correction in the real estate market might expose local banks to higher credit risk and weigh down on asset quality.

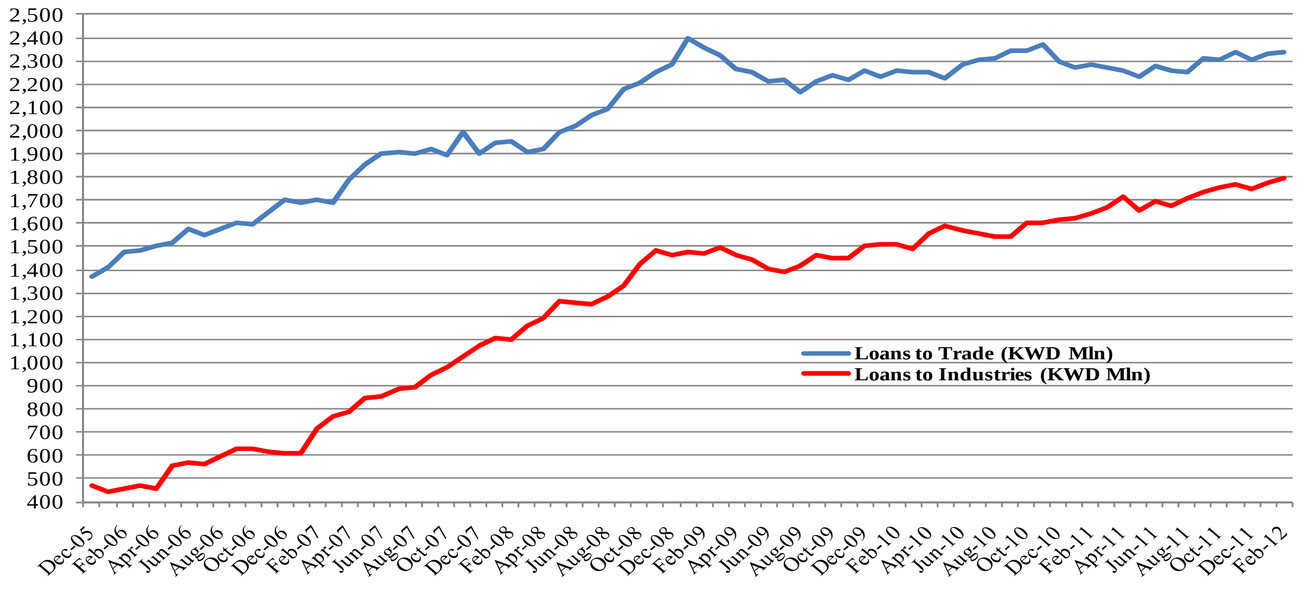
Chart 3. Evolution of Loans to the Real Estate & Construction versus those to Investment Companies



Source: KAMCO Research & Central Bank of Kuwait

The most adverse impact of the credit crisis was on loans to non-bank financial institutions (Investment Companies- ICs); banks suddenly stopped lending to ICs in the last quarter of 2008 following easy credit in the pre-crisis period when loans to ICs grew at a CAGR of 55% over the period 2004-2007. Since then, credit slowed down to 19% in 2008 and then followed a steep downward trend in the years that followed. Banks remain cautious in extending additional credit ICs given the challenging business environment and the deterioration in their financial standing and credit profile; accordingly, credit facilities to ICs fell in December-11 by 2% to KWD 2.38 bn, representing 9.3% of banks' loan portfolios; thus credit to ICs dropped sharply by 16% in 2011. Though the adverse impact of IC's doubtful debt has been priced in banks books, current market conditions and possible deterioration in IC's financial standing along with delay in implementing restructuring plans could result in booking further provisions by banks. The negative trend continued into 2012 as loans to IC's dropped further by 2% or KWD 39.5 mn to stand at KWD 2.3 bn in February-12.

Chart 4. Evolution of Loans to Trade versus Industrial Loans

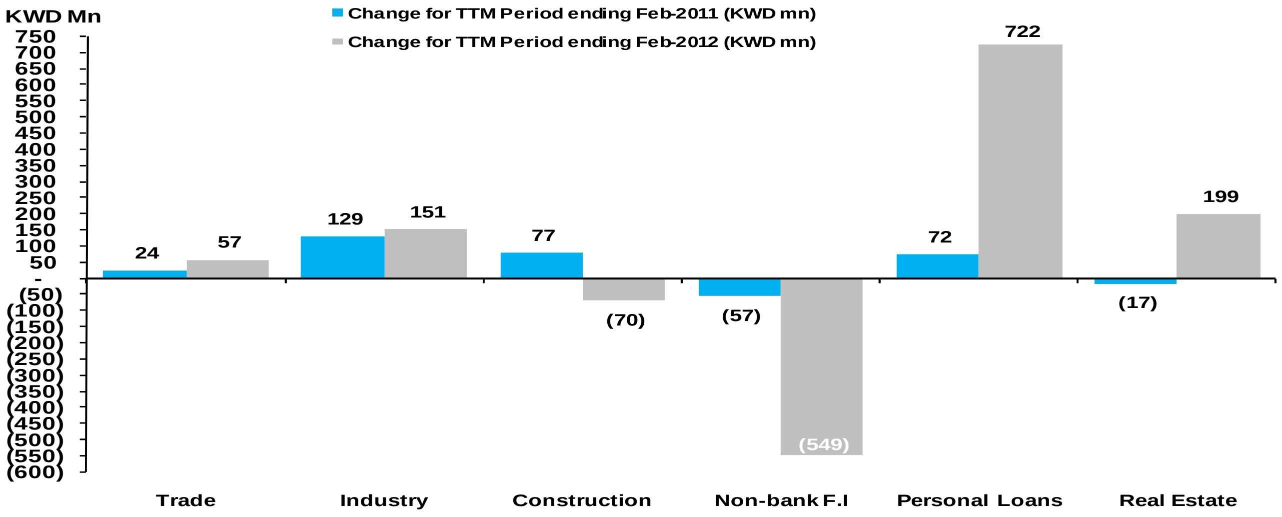


Source: KAMCO Research & Central Bank of Kuwait

During February-12, loans to trade rose KWD 6.3 mn following a KWD 24.7 mn increase registered the prior month. Although loans to trade began 2012 on a positive note, The drop in extending credit to trade during the past 3 years was due to tight credit conditions. Meanwhile, industrial loans jumped KWD 132.5 mn, in 2011 following a KWD 116.7 mn increase registered in 2010. The growth in industrial loans is part of a longer term trend that began in 2007 as bank strategy shifted towards directing more funds to the productive economic sectors that are backed by real cash flows

Chart 5, which depicts the change in outstanding loans across the major economic sectors during the TTM period ending Feb-12 and Feb-11, reflects a considerable growth in personal loans and credit to real estate and industrial sectors along with shrinking credit to ICs and construction due to the strict lending policies followed by local banks.

Chart 5. Change in Loans extended by Kuwaiti Banks across different Sectors



Source: KAMCO Research & Central Bank of Kuwait

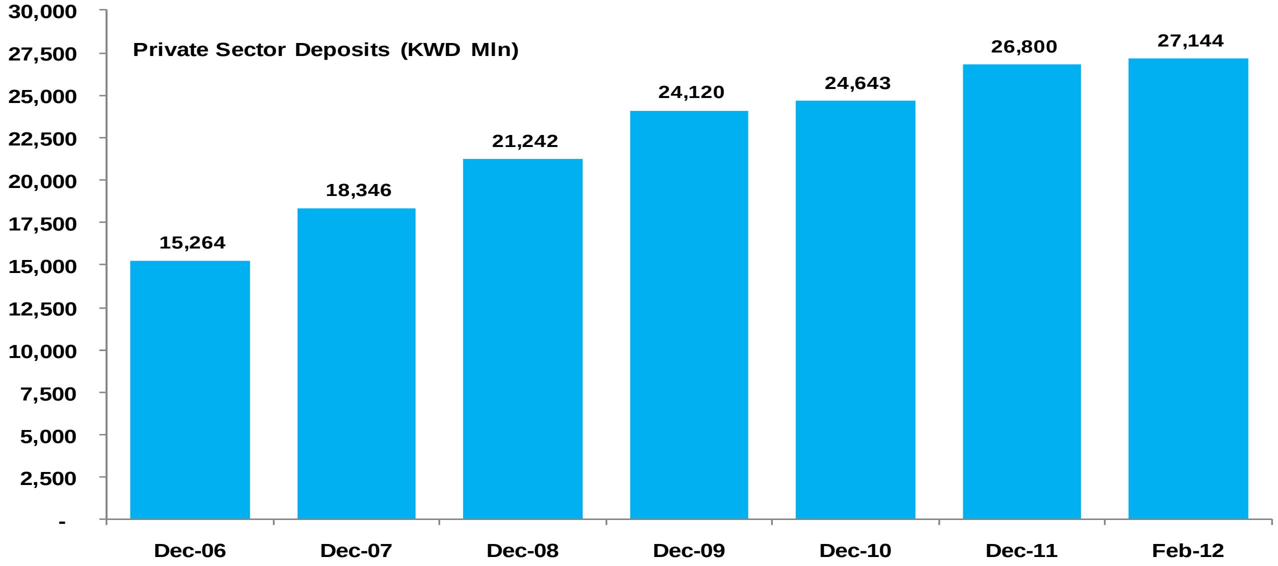
During the TTM period ending Feb-12, credit to the real estate sector grew by KWD 199 mn, while growth in personal facilities showed significant improvement. On the other hand, credit to ICs contracted by KWD 549 mn and KWD 57 mn in both periods, indicating the deterioration in operating environment, weak financial standing of some major players along with the restructuring of some highly leveraged firms and the significant losses incurred by the sector originated mainly from drop in the prices of equities and real estate. The impact of the investment sector on local banks is expected to be manageable in the near-term, due to the high level of provisions that have already been built-up against this sector.

Personal facilities added KWD 722 mn in during the same period fuelled by the increase in consumption and the reassessment of banks strategies that became retail-oriented. The Industrial sector has gained a new credit of KWD 151 mn, higher than the increase witnessed during the comparable period in 2011. The sustainable growth in credit to the industrial sector since 2009 is mainly driven by the banks' new strategy to direct more funds to the productive economic sectors that are backed by real cash flows.

Deposits with Kuwaiti Banks

Banks' deposit base (public and private) continued the upward trend for the eighth month in a row and added around 0.91% or KWD 280 mn, to end February-12 at KWD 31.1 bn. Private sector deposits, which represent 87% of local Banks' deposit base, increased by KWD 283 mn or 1.1% to stand at KWD 27.1 bn. Growth in private sector deposits has accelerated during 2011 to record 8.8% compared to 2.2% in 2010. This growth was mainly fuelled by the Amiri grant which took place in February 2011 when private sector deposits increased by KWD 1.22 bn in addition to the volatility in financial markets which resulted in flight to safety.

Chart 6. Private Sector Deposits (KWD Mln)



Source: KAMCO Research & Central Bank of Kuwait

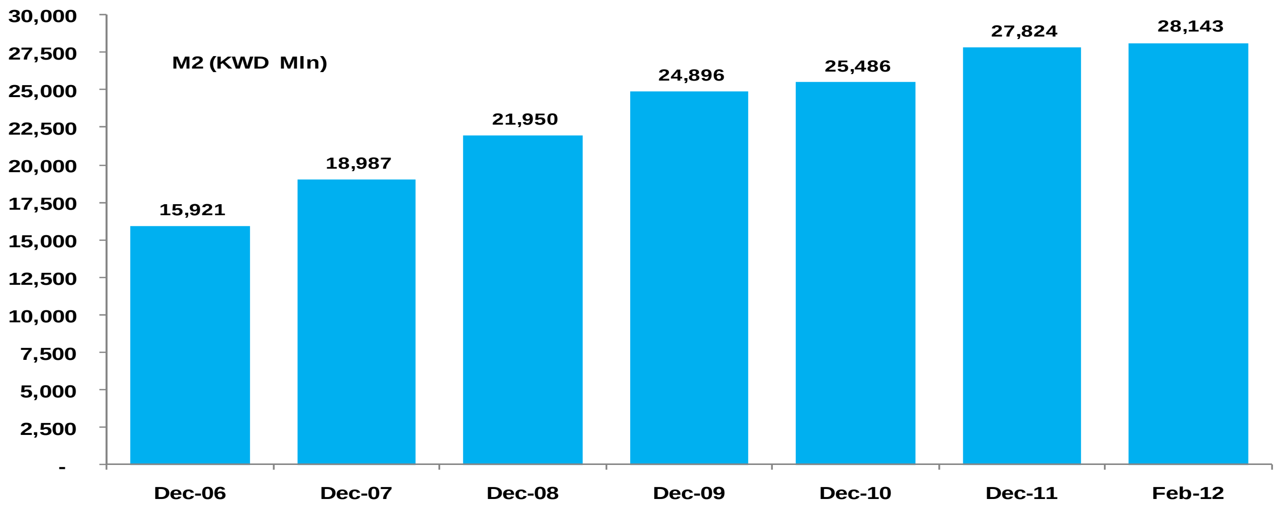
Government deposits, which account for 13% of banks' deposit base, fell a marginal 0.07% or KWD 3 mn during February to record KWD 4 bn. After recording a significant increase of KWD 449 mn in 2009 driven by the government intervention in the banking system, government deposits during 2010 dropped by 4% or KWD 163 mn amid easing concerns about the financial standing of local banks; this was carried-over in 2011, seeing government deposits losing 1% or KWD 38.8 mn. Injecting public money to the banking system has maintained confidence in local banks and improved liquidity, however, it failed to stimulate credit growth as local banks remained reluctant in extending credit to some sectors, namely financial and real estate.

Money Supply

Kuwait's broad measure of money supply (M2) continued the last six month's upward trend, to rise by KWD 285.6 mn or 1% during February-12 and stand at KWD 28.2 bn. The rise in M2 is mainly attributed to the increase in sight deposits by 2.6% or KWD 150 mn to stand at KWD 5.84 bn; while quasi money increased 0.6% or KWD 133 mn to reach KWD 21.3 bn.

However, in an analysis of the evolution in money supply and its effect on credit facilities, it is evident that the significant expansion seen in money supply following the year 2008 failed to spur growth in the credit market as banks became more cautious in their lending policies. In February-12, credit facilities added a KWD 243 mn (a growth rate of 0.9%) compared to January-12, while M2 and deposits added around KWD 285.6 mn (1.0%) and KWD 280 mn (0.94%), respectively, over the same period.

Chart 7. Money Supply (M2) Since December 2006 (KWD Mln)

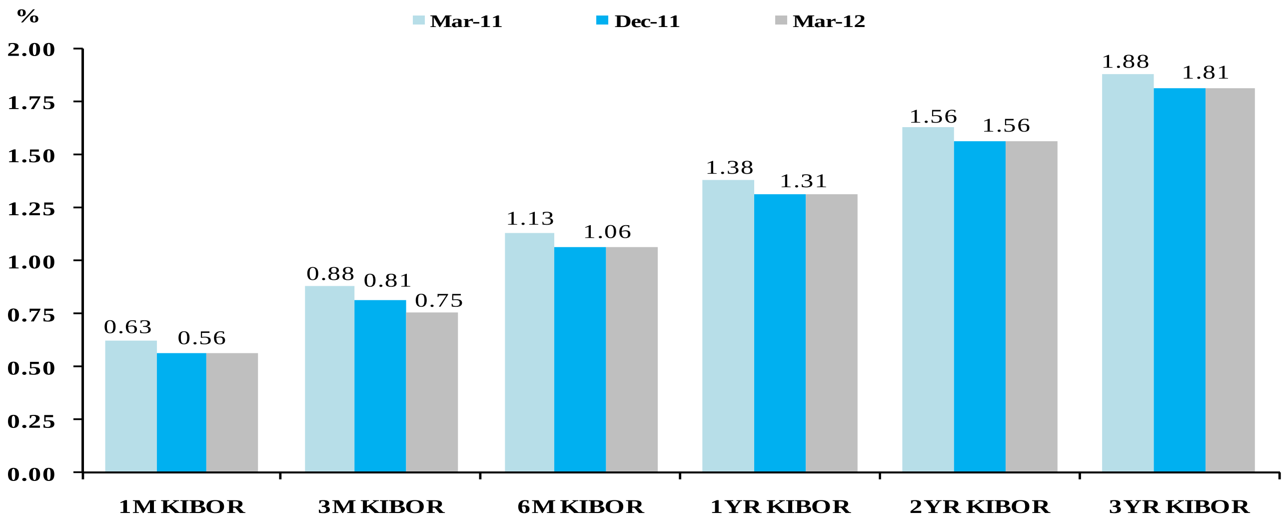


Source: KAMCO Research & Central Bank of Kuwait

Interest Rates

Kuwait Inter-bank Offered Rates (KIBOR) across different maturities remained unchanged during March-12 with the exception for the 3-month KIBOR rate which fell 6 bp to 0.75%. While, London Interbank Offered Rate (LIBOR) that banks charge each other for 3-month loans decreased by 3 bp to average 0.47% in March-12; likewise, the 6-month and 12-month LIBOR decreased by 1 bps and 2 bp averaging around 0.74% and 1.05%, respectively. Meanwhile, the spread between the 3M KIBOR and 3M LIBOR increased to 28 bps, up by 4 bp from December levels.

Chart 8. Average Daily KIBOR (Jan-11 to Jan-12)



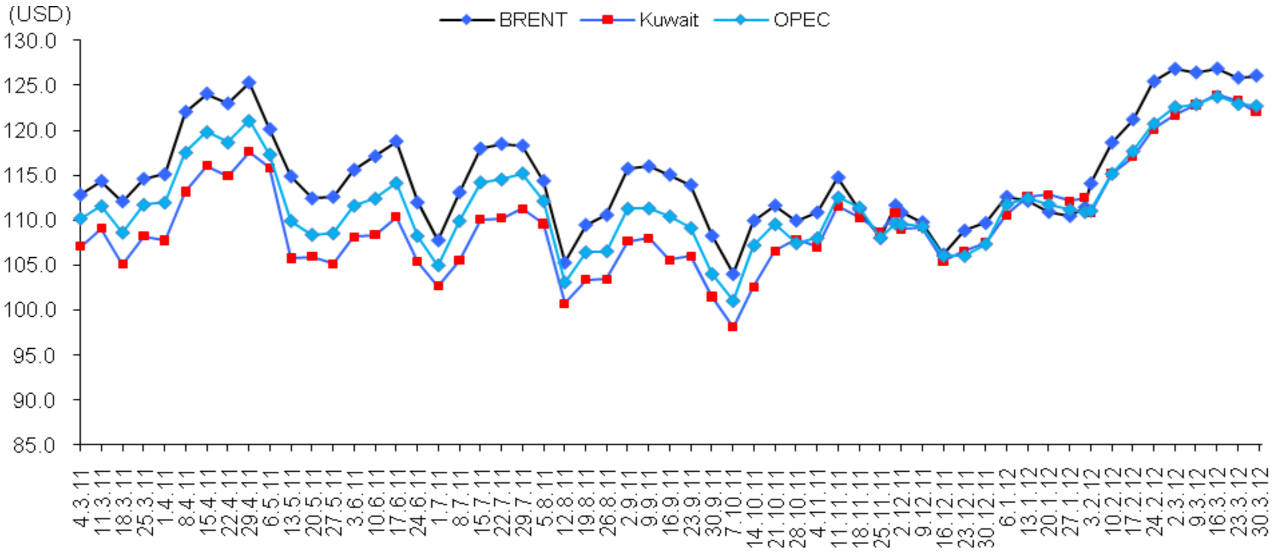
Source: KAMCO Research & Bloomberg

Oil Market

Oil prices remained elevated in March as supply continued to be pressured by geopolitical tensions coupled with improvement of US economic data and some positive developments in the Greek financial bailout. Furthermore, geopolitical factors were further amplified by speculators that are pressuring prices and sustaining them at elevated levels. The sanctions on Iran in particular have caused some chaos in oil markets complicating the settlement mechanism with other countries; furthermore, Europe had declared that it would stop imports from the country in the summer, which prompted Iran to pre-emptively cut exports to some European nations. Crude oil prices have been increasingly volatile since mid-2011 amid rising concerns about the economic uncertainties with crude prices direction broadly tracking fluctuation in equity markets, therefore keeping oil prices sensitive to ongoing macroeconomic developments. Price volatility has subdued slightly with OPEC basket moving within a range of USD 121.61-124.64/b during March-12.

On a monthly basis, OPEC oil prices averaged USD 123.1/b during March-12, an increase of around 5% from last month's average of USD 117.5/b and closed the month at USD 121.6/b. Nevertheless, the average YTD-12 price reached USD 117.4/b compared to an average of USD 101.3/b for the same period 2011, while the average price in 2010's comparable period was at USD 75.4/b. On the other hand, Kuwait Blend Spot Price FOB averaged USD 122.9/b and closed the month at USD 120.3/b, down from USD 121.5/b recorded at the end of Feb-2012. As well, European Brent Blend Spot Price FOB averaged around USD 126.3/b, up by around 4% from an average of USD 121/b recorded during Feb-2012, to close the month at USD 124.9/b.

Chart 9. Daily Spot Oil Prices for OPEC Basket, Kuwait, and European Brent – March 2011 / March 2012



Source: KAMCO Research & Energy Info. Administration, US Dep. of Energy

World Oil Demand - Supply

World oil demand in February is estimated to have averaged 89.11 mb/d, a slight 31 tb/d increase from last month. The adjustment reflects a strong Q1-12 globally as equity markets rallied as geopolitical tensions remained high pressuring oil prices further. However, the forecast does anticipate an increase in oil consumption in Non-OECD emerging markets especially China, other Asian countries, Latin America and the Middle East; the largest growth in consumption is expected from China with a growth forecast of 0.39 mb/d representing 45% of global growth in demand, while the remaining growth is spread evenly between the rest of the growth regions.

Table 1. World Oil Demand Forecast 2011-2012, mb/d

	2011	Q1-12	Q2-12	Q3-12	Q4-12	2012
North America	23.55	23.33	23.43	23.70	23.51	23.49
Western Europe	14.34	13.91	13.89	14.50	14.09	14.10
OECD Pacific	7.89	8.46	7.22	7.81	8.40	7.97
Total OECD	**45.78**	**45.70**	**44.53**	**46.01**	**46.00**	**45.56**
Other Asia	10.47	10.55	10.71	10.59	10.84	10.67
Latin America	6.36	6.31	6.50	6.68	6.59	6.52
Middle East	7.46	7.48	7.54	7.92	7.59	7.63
Africa	3.37	3.45	3.41	3.29	3.45	3.40
T. Dev. Countries	**27.65**	**27.78**	**28.17**	**28.48**	**28.46**	**28.23**
FSU	4.24	4.24	4.08	4.5	4.54	4.34
Other Europe	0.69	0.69	0.65	0.69	0.76	0.70
China	9.41	9.43	9.98	9.81	9.98	9.80
T. Other Regions	**14.34**	**14.36**	**14.71**	**15.00**	**15.28**	**14.84**
Total World	**87.77**	**87.84**	**87.41**	**89.50**	**89.74**	**88.63**

FSU: Former Soviet Union
Source: OPEC Monthly Oil Market Report (March 2012)

Non-OPEC oil supply is estimated to have increased slightly in 2011 by 30 tb/d to 52.3 mb/d, a 60 tb/d correction from last month's estimate. Supply estimates for the US, Canada, Norway, Yemen and former Sudan have undergone minor upward revisions, while output figures for Australia, Brazil, Syria, Azerbaijan and China have undergone minor downward revisions. Supply forecast has encountered various upward and downward revisions mainly due to political, technical and geopolitical factors. For 2012, Non-OPEC oil supply is forecasted to increase by 0.61 mb/d to average around 52.95 mb/d, with the bulk of the increase coming from the US, Brazil, Canada, Colombia, and Russia. In February, OPEC crude oil production averaged 30.97 mb/d, a 144 tb/d rise; oil production from Libya, Iraq and Angola increased, while Saudi Arabia, Iran and Kuwait's production declined.

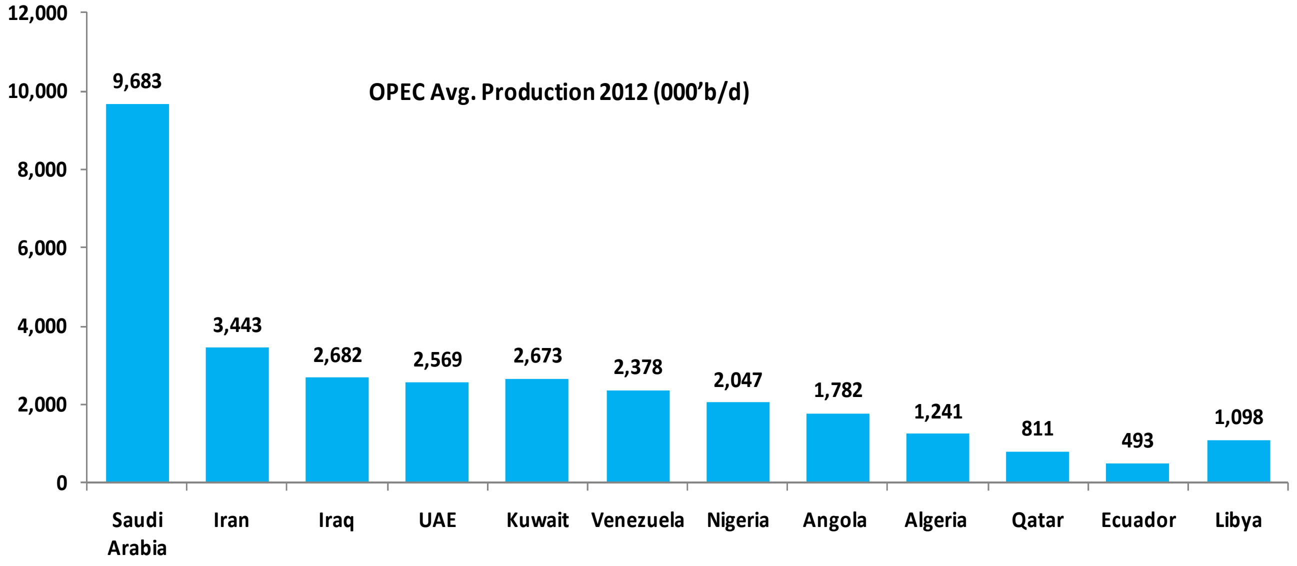
Table 2. World Oil Supply/Demand Balance, mb/d

	2011	Q1 12	Q2 12	Q3 12	Q4 12	2012
World Oil Demand	**87.77**	**87.84**	**87.41**	**89.50**	**89.74**	**88.63**
Non-OPEC Supply	**52.34**	**52.74**	**52.71**	**52.96**	**53.37**	**52.95**
OPEC NGL & non-conv.	5.29	5.50	5.61	5.71	5.79	5.65
Supply Excl. OPEC Crude	**57.63**	**58.24**	**58.32**	**58.67**	**59.16**	**58.60**
Difference	**30.15**	**29.60**	**29.10**	**30.83**	**30.58**	**30.03**

Source: OPEC Monthly Oil Market Report (March 2012)

Preliminary figures indicate that global oil supply decreased 31 tb/d in Feb-12 to average 89.11 mb/d; OPEC crude production increased by 0.14 mb/d. The share of OPEC crude oil in global production increased slightly to 35%.

Chart 10. OPEC YTD-12 Average Production by Country (000'b/d)



Source: OPEC Monthly Oil Market Report (March 2012)

Disclaimer

This document and material contained herewith have been produced, complied, and issued by KIPCO Asset Management Company KSC Closed (KAMCO). The Company has obtained the information used in this document from sources it believes to be reliable, but the issuer does not guarantee, neither its accuracy nor completeness, nor provides an independent verification of the material contained therein. KAMCO may, from time to time to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities, perform services for or solicit business from such issuer and/or have a position or effect transactions in the securities or options thereof. KAMCO may, to extent permitted by the applicable Kuwaiti law or other applicable laws and regulations, effect transactions in the securities before this material is published to recipients. The opinions and estimates expressed herein are those of the issuer and subject to change at any time without any prior notice. Accordingly, no representation or warranty, expressed or implied, is made as to and no reliance should be placed on the fairness, accuracy, completeness or correctness of the information and opinions contained in this document. KAMCO accepts no liability for any loss arising from the use of this document or its contents or otherwise arising in connection therewith. This document should not relied upon or used in substitution for the exercise of sound judgment. KAMCO shall have no responsibility or liability whatsoever in respect of any inaccuracy in or omission from this or any other document prepared by KAMCO for, or sent by KAMCO to any entity, and any such entity shall be responsible for conducting its own scrutiny, investigation, and analysis of the information contained or referred to in this document and of evaluating the merits and risks involved in the securities forming the subject matter of this or other such document.

Opinions and estimates constitute KAMCO's judgment and are subject to change without prior notice. Past performance is not an indicator of future results. This document does not constitute an offer or invitation to subscribe for or purchase any securities, and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. This document is not an offer to sell or a solicitation to buy any securities. It is being furnished to the reader solely for his/her information and may not to be redistributed inside Kuwait or by any jurisdiction outside Kuwait where this action is restricted by law. Entities who receive this report should make themselves aware of and adhere to any such restrictions. By accepting receipt of this report, the reader agrees to be bound by the foregoing limitations.